Finance Matters Inspiring Debates

Finance Matters' first event of a new series, the Inspiring Debates, was held on May 27th. The event was designed to take the issue of impact in finance to the next level with an in-depth discussion using specific case studies led by Dr. Raj Thamotheram.

Our event took place at the House of St. Barnabas, a beautiful venue in Soho that serves a dual purpose – a members' club, and the location of employment skills training for homeless Londoners. Raj Thamotheram was a brilliant speaker and challenged the audience with two cases rooted in real life.

The evening began with a brief yet inspirational opening presentation by Raj. Then, our members were divided into 4 groups to facilitate the discussions and share their own experiences.

The first case we discussed was *A Personal Struggle with the Definition of Success* by Professor Mary Gentile of Giving Voice to Values. This case features a successful investor and partner at a private equity firm. The subject describes how difficult it is for someone to be consistent with their values when they are not at the "top" of their organizations; on the other hand, he also realized that "The higher I've gone in my career, the more limited and pressured I often feel with regard to my values."

The case involved several questions to be considered, such as: Why was it so difficult for us to accept that someone can behave badly and still be rewarded within an organization? How do you define success? How do you define your purpose and how are the two related? What is your point of view in relation to the author's comment: "*I'd like to be able to embrace the classical definitions of success, accepting that true success is not necessarily*

about "winning" or financial success or always being recognized and rewarded. I'd like to be able to embrace the idea that true success is more an internal than external phenomenon. But these ideas often seem to be overwhelmed by real world evidence..." What are the implications of this perspective for you?

Below are some of the key observations raised among the groups:

- It was acknowledged that big institutions would be more difficult to move than small ones and that change would take time. As such, job applicants should research the values and culture of their company carefully before they accept a job
- Some believed that the more power you have, the more you have a duty to speak out for your own values. However, if your beliefs are not in line with the company's it's even harder to put that in practice
- At the same time, all had at some point shared the frustration of not being at the top of the organization, and the sensation of being powerless
- Interestingly, one participant who ran their own business stated that they saw their impact as providing a secure employment for their team, and that those responsibilities at times meant they had to be agnostic about certain preferences or behaviors of their clients
- Most people touched on the dynamic of ethics and morality vs. professional development and work place politics – agreeing that this is something they have all encountered at some point in their own careers
- The assumption that achievement links directly to financial reward triggered a debate around "success", and what it meant to each individual within the group. While a broader definition of success was shared by most, it was recognized that detaching it completely from financial achievement was not realistic, at least at the early stages of one's career
- Finally, it was pointed out that people often underestimated the impact small changes can have and, as a result, everyone should be encouraged to do make some of these small changes that enable them to express their values at work
- Participants also brainstormed how the trade-off between social values and career development might be decreasing, citing a recent study on Millennials and their desire for a more fulfilling career; an idea certainly reinforced by the conversation in the room

Raj's suggestion to the groups was to keep in mind that one cannot be successful over the long term if one operates on his or her own. Building internal support and forming alliances is a prerequisite if we want to be successful over good and bad times. If you search, you will find a person in the right position who is willing to support your effort, which will then be much more effective. He also gave us an example of why we should question the natural (and easy) assumption of powerlessness - at Mozilla Firefox, Brendan Eich who was forced to resign as CEO after it became known that he had given a personal donation in support of California's gay marriage ban. One of the triggers was a public tweet by a staff member asking him (politely) to step down. That individual is still working at the company.

But we didn't stop here. The second case was based on an article "*Put the Bee Back in Beta"* by Raj Thamotheram and Aidan Ward. The case study tackled the material decline in the bee population that we are witnessing today. At the heart of the problem are Neoticotinoids, pesticides produced by Bayer and a few other chemical manufactures, largely used in agriculture all over the world and deemed harmful to bees.

The four groups were given specific roles to help bring up contrasting viewpoints and a bit of vivacity to the discussion. In line with the Giving Voice to Values methodology, the groups were asked to assume that the person they represented really wanted to help address the problem and thus, this case study was not about deciding what was the right ethical thing to do but rather, how best to get consensus and action.

Group 1 was tasked to think through the lens of an analyst covering Bayer at a major asset management firm, with a medium to long-term investment horizon. The analyst was about to update their recommendation to the investment committee on whether to maintain, increase or reduce their holding in Bayer.

The group's decision was to recommend other companies that offer similar products without the negative side effects on bees. They also said they would include the potential risk it can bring to the portfolios in their analysis. They affirmed that the financial upside had largely been already realized and that more innovative and research-driven organizations in the sector would bear more upside. The thought process goes as follows:

1. First of all, consider the fiduciary duty a finance professional has towards clients, therefore ensuring that the capital of the investors is not compromised
2. At the same time, as an analyst, recognize that this investment may upset part of the investor base and therefore enhance the risk of investors pulling their funds
3. Think about original, substitute investment opportunities with the same or more financial upside, but without the negative externalities
4. Use a positive screen as a differentiation factor when fundraising, rather than a negative screen as a limitation factor to the strategy

Group 2 was representing the Head of the CSR department at Bayer and needed to communicate to stakeholders about the CropScience division's safety and quality standards, in particular concerning the Bee Health and Crop Protection section, in the context of publishing a company sustainability report.

They had a tough task given the strong limitations given by not contradicting the company's previous press releases opposing the EU ban to Neonicotinoids. As such, the group decided the CSR officer's best bet was to focus on remediation efforts via *impollinators* and on increased research activity on the same theme. The group also thought the CSR officer should be vocal in internal conversations about the fact that the long term sustainability and license to operate the business will only be possible if stakeholders trust the company to look after their best interests. The group felt this might give the CSR officer more space to operate.

Group 3 played the role of the CEO of a large pension fund that held a sizeable investment in Bayer's shares, which performed very well in the past year. They were asked to reaffirm their fund's interpretation of fiduciary duty and the integration of ESG issues into the fund's investment policy, using Bayer as a specific case.

The group's chosen action was to pressure the Board on investing extensively in external, independent research to measure the real risks of the pesticide, and to step up R&D on alternative, new products with lower negative externalities. It is indeed crucial to care for the environment while making profits, as a necessity to the long term wellbeing (and survival) of all of the pension system's beneficiaries. This implies that the fiduciary duty goes beyond pure financial result, and beyond the divestment debate. The group suggested that fiduciary duty can be better effected by taking responsibility as an active shareholder who is capable of influencing the decision makers. Moreover, it was suggested that the CEO could lead a group of like-minded pension funds to collectively influence the company's decisions in a coordinated fashion. This approach shifts the conversation away from a pure value-for-values tradeoff, into a constructive, market-led, coordinated action, that has a better chance of bearing the results sought without differentially penalizing any of the individual stakeholders or investors.

Finally, Group 4 represented the Chairman of Bayer, participating in the Board meeting to approve the next five-year investment plan, which included further investments in the production and distribution of harmful agricultural pesticides. The Chairman had to voice his concern and convince the Board to vote against the plan at the meeting.

The Chairman decided not to recommend that Bayer take the pesticides out of the market immediately, as that would not be financially viable and would be strongly resisted by others in the company. Instead, the Chairman convinced the Board to start to phase out production and invest in research into less environmentally-harmful products. The levers he used included reminding other Board members of the very mission of Bayer as an organization and its own reasons to exist. Being the first mover towards more sustainable products would clearly differentiate the company from its closest competitor in this field, Syngenta. This strategy would also help protect Bayer's long term business model, as bees are essential for agriculture, and thus for the future survival of the business model itself, although over decades. Moreover, the group suggested quantifying the potential legal and environmental damage compensation costs as another effective lever to influence the Board. Showing that Bayer is a forward-thinking organization willing to do its part for environmentally-friendly agricultural practices was an important message to pass on to the stakeholders.

Our moderator Raj concluded with a discussion of the ideas generated. He acknowledged that when one looks at the case we tend to think that nothing can be done but, after hearing the groups' insights, it was clear that an individual can be the catalyst for change if he or she is willing to push the boundaries – even slightly. Raj also highlighted the suggestion of collaboration across pension funds, mentioned by Group 3 and suggested that this could be taken forward more broadly as a system effort across different market participants in various finance roles. Indeed, we can be too concentrated on our own slice of the financial system, when collaboration and a network across a variety of actors can be extremely powerful. An endorsement of Finance Matters' own proposition!

Raj concluded Finance Matters' Inspiring Debate with a review of the Preventable Surprise of BP's Gulf of Mexico spill and what analysts can learn from it (but questioned: have they?). This accident and other similar ones show that there is a very narrow conception of risks across companies and intermediaries, which tend to dismiss isolated events as "black swan events" without being able to read the early warning signs nor learning from the events when they finally happen. The 6 typical characteristics of a Preventable Surprise are:

- Narrow Conception of Risk (think of Health & Safety)
- Shareholder Value Fundamentalism (cost-cutting has consequences!)
- Leadership and Governance Failures (i.e. Boards not performing to standard)
- Organizational Learning Disabilities (not recognizing the previous, numerous warning signs)
- Regulatory Capture (regulation is too often ex-post or beholden to corporate interests)
- Weak Concern for Negative Externalities (ignorance or conscious pursue of self-interest?)

We believe we need to understand the importance of long-term sustainable investments. We can't let systemic risks continue to impact our society and future generations. It's all about what we choose to value, what we want to do. As Raj put it, no one is rich enough to protect him or herself from climate change.

In tandem, the case studies drove home the importance of implementing values in our community. Collective actions are more effective than individual ones. And inside organizations, even if you're in a junior position, you can certainly still project your values. You don't need to wait until you're at the top. When you're willing to change, acting within the system, you can actually give voice to your values. And this is not about learning or studying, it's all about practice. Let's start practicing this now!

<u>More on Raj Thamotheram</u>

Raj is an independent strategic adviser, CEO of Preventable Surprises, President Emeritus of the Network for Sustainable Financial Markets and a visiting fellow at the Smith School at Oxford University. With 13 years of experience in ESG investing, he is a well-recognized international thought leader on "investing as if the long term matters". He led us through his 'Preventable Surprises' analytical framework to discover if many of the recent crisis and events were really so "unforeseeable". Through Preventable Surprises, Raj explains how certain high-impact, low-probability events are often dismissed as "black swans", but this discourages investor learning, especially about their own role. With this, he advocates support for the importance of considering "sustainable cash flows" and "ESG beta".

<u>More on Finance Matters</u>

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